The Canadian Farm Crisis

A Result of Foreign Impacts

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During the last five years Alberta's economy has gone through its toughest period since the Great Depression of the 1930s. The two dominant sectors of the economy, fossil fuels and agriculture, are facing a severe downturn. This paper is focussed on the agricultural sector where farmers are caught in a serious cost-price squeeze, aggravated by plummeting property values. An increasing number of farmers are in arrears with their debt servicing, farm foreclosures and repossessions are on the rise and many of the secondary bussinesses in Alberta's rural towns undergo considerable financial hardship. It will be argued that this situation is to a large extent the result of factors determined outside Canada and thus beyond the influence of Canadian farmers and decision-makers. These factors will be examined in some detail and it will be argued that Canadian politicians have neither the electoral support nor the financial resources to preserve the rural economy as we know it today. The only solution to the impending disaster facing agriculture in industrialized societies are carefully conducted multilateral negotiations which have as their goal the gradual reduction of agricultural subsidies. If this transition takes place over a reasonable amount of time, economic and social costs of necessary adjustments can be minimized and will be greatly outweighed by the benefits of efficiently allocated resources.

Several elements of the cost of agricultural production have experienced exorbitant increases in the past few years which by far exceed the overall rate of inflation. A great number of agricultural inputs are based on processed fossil fuels. Diesel fuel, gasoline and lubricants are necessary to run farm implements and vehicles, natural gas and heating oil are required to heat livestock barns, workshops and farm houses and fertilizers are used to increase crop yields. Like all oil and gas products these items were affected by the changes on world oil markets as they unfolded since 1973. Crude oil prices increased many times over when in 1973 the Opec cartel imposed its first oil embargo in response to the continuing Middle East conflict. The world had barely adjusted to the new energy scenario when in 1979 oil prices jumped to US$ 40.00 a barrel when Iran and Iraq went to war. As a result of these developments operating expenses for fuels, lubricants and fertilizers increased from $ 88.2 million in 1971 to $ 574.2 million in 1983.[1]

The recent collapse of the Opec cartel led to a reduction of world oil prices from around US$ 30.00 in late 1985 to somewhere between US$ 10.00 and US$ 13.00 per barrel in mid 1986. Although these price declines have been passed on to consumers, there is disagreement as to the degree to which end users of the resource benefit. In any case, the volatility of world oil prices should not be relied on for prudent financial decisions. Although the reduced fuel prices are welcome at the present time, they might turn out to be of precariously temporary nature.

Competitive pressures and a precipitous decline in available farm

labour were and are forcing today's farmers to invest heavily in capital intensive production methods. The use of automated feeding systems, milking machines, augers, tractors and combines, to name a few, have considerably reduced the input of manual labour into farming techniques. The agricultural implement industry is overwhelmingly owned by a few large US corporations. Thus farm machinery must either be imported from the US or is purchased from Canadian subsidiaries in Canada which use a great number of American components. The persistent decline of the Canadian dollar's value relative to its American counterpart has resulted in average annual price increases of 13 per cent between 1971 and 1984.[2] Obviously these price hikes which outstrip general inflation by a wide margin, have contributed considerably to the financial burden on farmers.

The main contributor to the bleak financial situation of present day farming is the price of money. Credit availability is an absolutely crucial element of a modern farm operation. Prior to the Second World War, most of the inputs required for farm production were produced right on the farm. The chief source of power was live horsepower. The fuel for this power source was grown on the farm; moreover, secondary output from this power source could be used as fertilizer! The agricultural industry in western Canada is far different today. Farmers now purchase from off farm sources most of the inputs they need for their production. Large scale short and long term financing is needed to operate, maintain and, if appropriate, to expand a farm enterprise. Every spring farmers have to borrow operating capital to put in their crops. Fuels, seeds, herbicides, pesticides and

fertilizers have to be purchased, machinery has to be maintained and livestock has to be bought. The money to pay for these expenses is usually borrowed against the fall crop and the sale of fattened animals. Long term financing is required for the acquisition of more land or the replacement of worn out or obsolete machinery. The farm expenditures for debt servicing in Alberta have risen from $ 57.5 million in 1971 to $ 489.9 million in 1981. This ten fold increase in capital expenses compares unfavourably with an only five fold increase in overall operating expenses for the same period of time.[3]

Once again the reasons for the extraordinary increases in capital costs are to be found outside Canada. The Canadian economy has traditionally be a relatively small and open one. Its strong resource base and small population has always necessitated a strong emphasis on foreign trade to obtain a wide range of goods not found or manufactured domestically. Canada's largest trading partner is the United States which represents a mrket roughly ten times the size of her own and which is the economically most powerful nation in the world. Consequently economic developments in the US have an immediate and direct impact on the Canadian economy.

In the 1970s all western economies were caught in a spiral of inflation which was fuelled by the decision of American policy makers to finance the exorbitantly expensive war in Vietnam through the printing of more and more new money.[4] At the same time credit was abundant and interest rates were low. In Canada real interest rates were even negative from 1973 to early 1976, i.e. the cost of borrowed money was lower than the rate of inflation.

These easy terms made farm land attractive as an investment vehicle and the resulting increase in demand pushed up land values much faster than inflation. At the same time commodity prices were relatively strong so that widespread optimism in the finance and farm communities created a debt financed farming bonanza.[5]

This whole scheme came to an abrupt end when the 1979 oil price hikes and the arrival of Reagonomics in 1980 threw the United States and the world as a whole into a severe recession. Paul Volcker, the president of the US Federal Reserve Bank, decided to fight inflation by suddenly clamping down on the growth of the US money supply. This created a shortage of funds which indeed brought down the rate of inflation fairly quickly, but at a horrendous price. Interest rates skyrocketed to historically unprecedented levels, commercial investment dried up and the resulting economic downturn created high levels of unemployment. Suddenly farmers in North America found themselves faced with high interest on their large debt loads, with rates exceeding 20 per cent at times.[6] The curb on inflation, together with the overall economic recession, reduced the demand for land to a degree where land values deflated alarmingly. In some states of the American midwest land prices plummeted by over 50 per cent between 1981 and 1986 [7] and the federal Farm Credit Corporation reported that Number 1 farmland in Alberta sold for 37 per cent less in 1984 than in 1983.[8]

Over the last two years world financial markets have settled down somewhat. Lending rates hover around ten per cent but in the face of around three per cent inflation in Alberta, real interest rates are still roughly at seven per cent. This is far above the historical real interest rate of

about two per cent and the rate of return of two to four per cent which the average farmer receives on his investment.[9]

The Farm Credit Corporation estimated that in 1984 in western Canada alone some 30.000 farmers were in severe financial stress. Unfortunately it is the beginning farmers and those who chose to invest heavily in equipment to boost their productivity who are now in danger of losing their livelihood.[10] Their situation would be a lot more encouraging if they could receive a reasonable price for the commodities they produce. The following paragraphs will show, however, that the income side of a farmer's balance sheet does not promise any relief of his financial conundrum for quite some time to come.

For about the last decade the world prices for agricultural products have been relatively poor. Real prices for wheat, for example, were around $ 5.00 per bushel in 1984 which is less than half of what it was in 1973.[11] What are the reasons for this situation? For the last decade or so agricultural production in the industrialized countries has resulted in chronic oversupplies which in turn are responsible for the downward pressure on world prices. The explanations for this phenomenon can be found by examining the agricultural policies of the main participants in global agricultural trade.

The member countries of the European Community are no newcomers to the problem of how to manage oversupplies of agricultural goods. Europe's silos are bursting with 18 million tons of unsold grain. One million tons of butter and 800.000 tons of beef are being stored in EC cold storage ware-

houses.[12] Ironically, European farmers have become victims of their own success. When the European Economic Community was founded in 1957 some of its purposes as stated in the Treaties of Rome were to raise farm productivity, give farmers an adequate standard of living, provide security of supply, stabilize food markets within Europe and maintain reasonable food prices.[13] These aims made sense at a time when the European countries were still reeling from the devastations of the Second World War. Self sufficiency was to be achieved by means of the Common Agricultural Policy (CAP) which was arguably successful as the EC is by now indeed self sufficient in virtually all farm commodities it can grow itself.[14]

The basic structure of CAP contained, however, the element which led to the present troubles in the European Community by offering open ended subsidies for any amount of produce farmers were able to grow regardless of market needs. European farmers, motivated by price guarantees and export subsidies, vastly increased their productivity. In France alone wheat output ballooned from 6.7 million tons in 1962 to to 29 million tons in 1984.[15] The member countries of the EC go to almost any length to dispose of these massive surplus stocks on the international markets. No precise information is available as to the amount of subsidies are shelled out to European producers to dump surplus produce on international markets. The Australian government has calculated, though, that her economy was set back by a whopping $ 4 billion since 1980 due to EC export subsidies.[16]

As a result of the EC's aggressive dumping practices its share of the export market for wheat has been climbing steadily over the last few years

at the expense of other exporters. Particularly badly affected were US producers whose market share fell from 38 per cent to 29 per cent within the last three years.[17] This comes at a time when the US is also trying to export some of the problems which its own agricultural policies have created over time.

The emergence of US farm surpluses goes back to the beginning of this century when the newly emerging cities of North America attracted rural inhabitants like a magnet. The increasing rural urban populations had to be fed with fewer and fewer farm hands. Consequently farmers had to increase their productivity through mechanization. When their efficiency created more commodities than could be consumed domestically, they could easily be sold abroad. After the end of the Second World War it became increasingly difficult to sell agricultural commodities abroad as Europe was lost as a market due to the self-sufficiency policies of the EC. US farmers also became victims of international politics when the Carter administation imposed a grain embargo on the USSR in the late 1970s as a response to the Soviet invasion of Afghanistan. Most recently the overvalued US dollar also made it difficult for many potential customers to afford US produce.

All these factors combined to throw American agriculture into a severe crisis which the Reagan administration recently addressed by passing the US Farm Bill. This bill will have a further depressing effect on world prices especially for wheat. The bill sets a so-called target price for a variety of crop items which guarantees the US farmer a fair return

on his investment. Should world prices be below this target price the US treasury will subsidize the farmer for the balance.[18] A few weeks ago Senator Robert Dole introduced another weapon in the ongoing trade war between the US and the EC over agricultural exports. In an absolutely stunning turnabout this bill asks for the subsidization of US grain sales to communist countries like the USSR or the People's Republic of China![19]

All these factors combine to depress world prices for agricultural products which in turn devastate the income picture for Canadian farmers. The major difference between Canada and the other major players in international commodity markets is the degree to which the agricultural sectors depend on export sales. For example, while American farmers have to sell only about 20 per cent of their wheat abroad, Canada exports in excess of 80 per cent of her wheat. This puts the American and European governments at a considerable advantage when it comes to financing subsidy schemes. Not only are their domestic markets between ten and fifteen times larger than Canada's, but they also have to foot a relatively much smaller bill for subsidized exports. This means that the per capita contribution of all taxpayers in those countries is only a fraction of that in Canada.[20]

What do Canadian governments do to alleviate the cost price squeeze in which Canadian farmers are caught? A great variety of support programs are in place which are administered by both provincial and federal governments. To name a few programs, the Alberta government alleviates input costs through the Farm Fuel Tax Rebate Program and subsidizes fertilizer costs through the Farm Fertilizer Price Protection Plan. In the last year alone these two programs amounted to around $ 230 million. At the present

time the details are being worked out for the Farm Finance Stability Program which will enable eligible farmers to receive long term financing at a fixed rate of nine per cent, thus removing the uncertainty of fluctuating interest rates from long range finanial planning. The cost of this program is estimated at some $ 2 billion. Federal support programs include an increase of the price of domestically consumed wheat to $ 10 per bushel and more favourable lending terms under the Farm Credit Corporation. Last year federal contributions to western agriculture amounted to around $ 1.5 billion.[21]

Although these aid programs are certainly helpful to Canadian farmers, the increasing number of financially troubled farms suggests that they are not sufficient. It is, however, questionable whether the deeply rooted problems of this sector can be solved in the long run by throwing ever more money at them. In times of economic problems for all Canadians and of fiscal restraint on all levels of government the electorateat large will eventually start questioning whether continuous subsidies to bail out a relatively small sector of the economy are justifiable.

The only solution to the problem of worldwide over supply of agricultural commodities lies in multilateral negotiations aimed at ending the war of subsidies. The forum for the conduct of such negotiation is the next meeting of the member nations of the General Agreement on Tariffs and Trade (GATT). It is safe to assume that not only Canadian voters and taxpayers will become increasingly disgruntled with the inefficient allocation of their tax money in international trade wars. The blatant discrepancy between the recent rhetoric about the benefits of enhanced trade and the reality

of costly trade wars particularly by the present US administration will not go unnoticed. Thus there will be considerable pressure on the participants to negotiate an end to the wasteful production and trade practices which prevail at the present time. Naturally this process will entail major adjustments in the agricultural sectors of the affected economies. If, however, the process of transition is handled carefully, there can be no doubt that in the long run farmers and consumers will be better off as available resources will be allocated in the most efficient manner and without artificial distortions.

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Footnotes

[1] Alberta, Economic Development, Alberta Industry and Resources 1984, (Edmonton, 1985), p. 45, table 2.13; hereafter: Alberta.

[2] Lois L. Ross, Prairie Lives (Toronto: Between the Lines, 1984), p. 7.

[3] Alberta, p. 45, table 2.13.

[4] Andrew Weiner, "Rock of Ages," Financial Post Moneywise Magazine, August 1986, p. 28.

[5] K.K. Klein and R. Barichello, Farm Finances in Western Canada (Calgary: Canada West Foundation, 1985), p. 6; hereafter: Farm Finances.

[6] Andrew H. Malcolm, Final Harvest (New York: Times Books: 1986), p. 108.

[7] Ward Sinclair, "Growing Despair on the Farm," The Washington Post Weekly National Edition, June 23, 1986, p. 8.

[8] Farm Finances, p. 8.

[9] Anne Fisher, "Farming's Mortgaged Future," Report on Business Magazine, May 1986, p. 26.

[10] Clyde Graham,"New PC Farm Policies Focus on Bleak Economic Truths," Edmonton Journal, July 8, 1986.

[11] Farm Finances, p. 9.

[12] Peter Lewis,"Europe's Farm Folly," Report on Business Magazine, June 1986, p. 48; hereafter Folly.

[13] ibid., p. 50.

[14] Simon Harris, Alan Swinbank and Guy Wilkinson, The Food and Farm Policies of the European Community (New York: John Wiley & Sons, 1983), p. 11.

[15] Folly, p. 50.

[16] ibid., p. 51.

[17] David Holehouse, "Farmers Facing Too Many Hurdles," Edmonton Journal, March 29, 1986.

[18] Roger Thompson,"Farm Finance," Editorial Research Reports, April 11, 1986, p. 277.

[19] "Lower Prices Possible for Canadian Grain," Edmonton Journal, Ju;y 16, 1986.

[20] Gene Laverty,"U.S. Policy Puts Squeeze on Farmers," Edmonton Sun, April 24, 1986.

[21] Joe Clark, "Threat to Farming Demands Global Action," Edmonton Journal, June 19, 1986.